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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1072

FORD MOTOR CREDIT COMPANY,

Petitioner,

v.

CATHERINE EDMONDSON,

Respondent.

PETITIONER'S REPLY MEMORANDUM

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Respondent has answered this Court's call for a response to the petition for a writ of certiorari by attempting to obscure the serious issues raised by the decision of the United States Court of Appeals for the Fifth Circuit in *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978). Petitioner Ford Motor Credit Company ("Ford Credit") submits this reply to address three new matters raised by respondent.

I. Respondent's Statement of Facts Obscures The Issues Before This Court.

In purporting to "supplement" petitioner's statement of the facts in this case, respondent relies upon two documents taken from outside the record. These documents are atypical and misleading.*

More importantly, petitioner's presentation *dehors* the record attempts to obscure the issue in this case, which has little to do with the amount of the insurance premiums in particular policies. The Fifth Circuit's decision has put in jeopardy millions of existing consumer credit transactions and the smooth functioning of the Nation's credit-based economy, by adopting a new rule which forces disclosure of any arguably "valuable economic right" as a security interest, although the Truth in Lending Act and implementing Regulation Z command disclosure only of those rights which "secure[ ] payment or performance of an obliga-

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* Because the documents have apparently been selected to create the misleading impression that Ford Credit's incidental interest in unearned physical damage insurance premiums is in fact an integral and important security interest taken in automobile financing transactions, they deserve a brief comment. One of the documents (Respondent's Appendix 1a-2a) and respondent's brief (at p. 2) refer to credit insurance—which has no relevance whatsoever to the physical damage insurance involved in this case. The assignment of unearned physical damage insurance premiums provides the lender no right to any interest in any other type of insurance that might be involved in the transaction. The other document (Respondent's Appendix 3a-4a) at least deals with the relevant type of insurance, but the transaction which respondent has called to the Court's attention is hardly representative. It involves atypical single interest physical damage insurance for the full term of the contract, and an insured amount substantially greater than the average balance involved in automobile financing transactions in the United States. *See,* Petition for Certiorari, n. 6 at p. 18.

The "single interest" physical damage insurance reflected in respondent's Appendix is not typically written in connection with the credit sale of an automobile, but, if obtained at all, is obtained subsequently by the creditor after the debtor has failed to provide the more usual dual interest insurance. Typically, dual interest physical damage insurance is written for a period of 6 or 12 months, not 35 months as indicated in respondent's Appendix, and dual interest policies do not permit the lender the unilateral right of policy cancellation.

tion." Regulation Z, 12 C.F.R. § 226.2(gg) (1978). In addition, with only the comment that "we need not tarry long over the complexities of Georgia's commercial law" the decision below wholly ignores the Federal Reserve Board's clear and repeated instruction to all who must comply with the Act to look to the commercial law of the states to determine whether there is any "security interest" which must be disclosed.* Respondent's transparent attempt at misdirection must not draw the Court's eye from the importance of the real issues in this case, industry-wide issues which demand this Court's attention.

II. Federal Reserve Board Letter No. 377 is Not Applicable To This Case.

Respondent argues that the Fifth Circuit's holding in *Edmondson* is consistent with interpretations of the Truth in Lending Act by the Federal Reserve Board. But against the substantial authorities cited in the petition for certiorari, respondent can advance only F.R.B. Letter No. 377 (1970). And even that authority is inapposite.

The F.R.B. staff there considered a situation in which borrowers would use the proceeds of a loan to purchase accidental death and dismemberment insurance. The creditor would take a security interest in unearned premiums paid for such insurance, and these unearned premiums would constitute the collateral on which the creditor would foreclose *in the event of default* in order to obtain repayment of the loan.

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* The Federal Reserve Board has referred lenders to state substantive law to determine whether each of the following interests constitutes a "security interest" which must be disclosed under the Act: Federal Reserve Board Staff Opinion No. 1263 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,736 (November 23, 1977) (assignment of insurance proceeds and unearned insurance premiums); Federal Reserve Board Staff Opinion No. 829 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,151 (August 22, 1974) (interest in after-acquired property); Federal Reserve Board Letter No. 114 (September 10, 1969) 2 Truth in Lending Manual, E-144 (3d ed. 1973) (agreement not to encumber); and Official Interpretation of Federal Reserve Board, 12 C.F.R. § 226.202 (May 26, 1969) (confession of judgment clauses and cognovit provisions).

But the assignment in the instant case is not geared to *default* at all. Nor does it provide the lender with a source of any significant recovery of the debt in the case of default. The sole purpose of assignment of unearned physical damage insurance premiums in cases like the present one is simply to assure that the financed vehicle—the subject of the true "security interest" in the transaction—remains insured during the life of the loan, and that the insurance premiums can be used by the borrower only for that purpose. This assignment has uniformly been disclosed on the back of millions of installment credit contracts presently in force only because lenders *never* intended or construed such collateral-protection provisions to secure payment of the loans involved.

Moreover, the staff's answer to the particular inquiry involved in Letter No. 377 is hardly surprising. If one asked the staff whether, on the facts of the present case, Ford Credit's interest in the *automobile* could be disclosed as a security interest, one would receive a similar answer. Just as the purchase of insurance was the object of the loan at issue in Letter No. 377, the purchase of an automobile was the object of the loan at issue in the present case.

Unearned physical damage insurance premiums are small to begin with, they decline over the life of the loan, and their availability to the creditor is unrelated to default. No creditor possessed of his senses would, in the context of a secured automobile loan, view this most uncertain and incidental right to unearned insurance premiums as a "security interest" which would support the loan. Here, as in *Teamsters v. Daniel*, 58 L.Ed.2d 808 (1979), the Court must give precise meaning to a statutory term which some would make all-embracing; here, as in *Daniel*, the Court should look to "the substance—the economic realities of the transaction" as they are commonly understood. 58 L.Ed.2d, at 816.

III. The Economic and Stare Decisis Impacts of the Decision Below Will Devastate the Credit Industry.

Respondent suggests that this case lacks importance because petitioner has changed its standard form contract in light of the Fifth Circuit's decision in *Edmondson*. Whether respondent's assertion is true or not (and the record is silent on this point also), it is wholly irrelevant for two reasons.

First, the *Edmondson* decision, if allowed to stand, will have a staggering effect upon contracts executed *before* the decision, as the petition argued and the brief of *amici curiae* The National Consumer Finance Association and General Motors Acceptance Corporation emphasized. *See*, Petition for Writ of Certiorari, at 18-20; Brief of *Amici Curiae*, at 12-15.

Second, even if its direct economic impact were not enormous, the *Edmondson* decision creates a more fundamental problem which will have a continuing and unsettling effect upon the Nation's credit-based economy if this Court declines review. The Fifth Circuit has, for all practical purposes, commanded that any "valuable economic right" available to the seller in a credit sale transaction be disclosed as a security interest. For the reasons advanced in the petition, this holding makes compliance with the Truth in Lending Act a guessing game. It is to this most fundamental issue that petitioner urges this Court to speak, in a case whose direct economic impact is enormous.

The definition of "security interest" in Regulation Z describes, by example, the types of security interests required to be disclosed. The examples given are all typical, well-recognized types of security interest. They make it clear that the Regulation focuses on security interests whose purpose and function is to secure the debt—*not* on interests in property whose purpose is wholly incidental to repayment of the loan at issue. Proper respect for the Board's Regulation, read together with the principle of *ejusdem generis,* should restrict the Act's disclosure requirement to typical security interests and halt it well short of the sort of incidental interest at issue in this case.

Indeed, the penal nature of the damages that may be imposed under the Act requires this conclusion. Under the Act, a civil penalty is imposed upon the creditor for an amount equal to double the amount of the finance charge (up to a $1,000 maximum) for any violation of the Act, no matter how technical and whether intentional or not. 15 U.S.C.A. § 1640(a). While petitioner recognizes that the Act has been viewed as remedial in nature, the statute also imposes what are clearly penalties, as Congress has recognized in the body of the Act itself.* A court should not impose a penalty for conduct not clearly proscribed in an act under the guise of liberally construing such legislation, especially where, as here, the purpose of the Act is not furthered by imposing the penalty.

Fundamental fairness and equity dictate that lenders be given more guidance as to what the law requires than the Fifth Circuit's new test gives before being held under a strict liability standard for even the most minor technical disclosure deviations and required to pay the Act's civil penalties. "[W]hen the Government makes [such] a new regulation excursion into the field of business, the act of the lawmaking body which evidences such departure must be so plain as to notify the ordinary citizen of the move." *Auers* v. *Phillips Petroleum Co.,* 25 F.Supp. 458, 459 (N.D. Tex. 1938)

For these reasons, and the reasons advanced in the petition for a writ of certiorari, petitioner urges the Court to grant a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit in this case.

Respectfully submitted,

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* Section 113 of the Act expressly recognizes that the civil recovery provided for under Section 130(a) of the Act is a "penalty." The language of Section 113 is as follows:

> "§ 113. *Penalties inapplicable to governmental agencies.*
>
> *No civil or criminal penalty provided under this title for any violation* thereof may be imposed upon the United States or any agency thereof, or upon any State or political subdivision thereof, or any agency of any State or political subdivision." (emphasis supplied)

Congressional recognition of the penal nature of one of its own enactments is persuasive authority in guiding the judiciary's construction of that statute. *Helwig* v. *United States,* 188 U.S. 605, 615, 23 S.Ct. 427, 430 (1902).